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Eliminate the 1% Residential Property Tax Cap

Prepared for the Citizens Finance Review Commission

by

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The proposal:

Under the Arizona Constitution (Article 9, Section 18), the maximum amount of primary property taxes that can be collected on a residential property in any tax year cannot exceed one percent of property's full cash value. This 1% limitation only applies to Primary taxes. Primary taxes are assessed on the limited value and used for the maintenance and operations budgets of the various tax jurisdictions. Voters added the 1% limitation to the constitution in 1980 to protect themselves from unreasonable increases in homeowner property taxes.

The 1% limitation doesn't apply to secondary tax assessments. Secondary taxes are assessed on the full cash value and are used to pay for debt service (principal and interest) on bonds, budget overrides, and special district levies. Secondary property taxes for bond debt service, budget overrides, and most levies by special property tax districts require voter approval.

The Legislature doesn't have the authority to change the Constitution. The Legislature can refer constitutional amendments to the voters.

The proposal before this commission is the elimination of the 1% residential property tax cap on primary taxes.

Please see appendix A for a list of the 23 tax jurisdictions that appear to be above the 1% limitation, after the homeowner's rebate, in FY 03 per JLBC.

How to administer this tax reform:

Systems and personnel are already in place at the County and State to administer and collect the residential property tax. The County Assessor determines the full cash and assessed taxable value. The County Treasurer prepares and collects the tax bills.

Impact of this tax reform on Existing Revenue Systems:

The residential property tax cap is primarily administered at the County level. A voter-approved change in the 1% limitation on the primary tax should result in minimal administrative costs to the County or State Government. The County will continue to determine residential property values and collect the tax. State and Counties can reduce administrative costs incurred to track the limitation. State can reduce cost of subsidies made to high primary tax rate jurisdictions.

After the homeowners rebate of 35%, the 1% cap affects ~23 tax jurisdictions. JLBC has estimated the State cost of the 1% cap at ~\$11M. Eliminating the cap results in a tax increase on homeowners in those jurisdictions.

Elimination of the 1% cap will make other property tax proposals before the CFRC less problematic. The proposal to reinstate a new statewide property tax would have the obvious impact of increasing the number of residential property taxpayers exceeding the 1% cap. In addition, proposals to decrease business assessment ratios for primary taxes will have the effect of increasing residential property taxes and increasing the number of residential properties above the 1% cap.

Cost to Administer proposal:

Because systems and personnel are already in place at the County and State to administer and collect the property tax, the cost to administer the elimination of the 1% cap should be minimal. Existing systems can be adjusted for changes in assessment ratios, 1% cap adjustments, etc.

Policy Considerations:

Equity

Elimination of the 1% cap improves horizontal equity by eliminating State subsidies to high tax rate jurisdictions & provides local taxing jurisdictions more flexibility in funding their operations.

Removal of the 1% cap also provides the Legislature with opportunities to equalize the property tax burden for all taxpayers (ex. reducing or eliminating the homeowners rebate, creating an equalized single assessment ratio for all taxpayers, etc).

Economic Vitality

The 1% cap helps promote residential development by holding down residential property taxes.

Elimination or narrowing of the disparity between residential and business property taxes will benefit all types of businesses and promote economic activity.

Volatility

The amount of property tax raised each year is moderately stable because of new construction and rising property values.

Simplicity

Elimination of the 1% cap simplifies administration of the property tax system by removing the requirement to track and adjust for the 1% limitation. High tax rate jurisdictions would no longer receive a subsidy from the State.

Elimination of the 1% cap requires a constitutional amendment, approved by a majority of the voters. Voters tend to reject tax increases unless used for specific purposes (ex. improve education funding).

Accountability:

As defined in the Fiscal 2000 study, accountability is “providing links between the revenue raising responsibility and the spending authority so that voters can hold elected officials responsible for both the revenue and spending decisions.” Clearly, the 1% cap frustrates the important criteria of a good fiscal system by breaking the link between the spending decisions of local government and the responsibility of residential taxpayers to participate in the funding those spending decisions.

Economic Impact:

Elimination of the 1% cap results in a property tax increase of ~\$11M for taxpayers in high tax rate jurisdictions (see Appendix A for list of jurisdictions). Of the \$11M, \$8M is for Tucson Unified School District and \$1.1M is for Apache Junction Unified.

Further, elimination of the 1% cap may provide opportunities for further property tax reform, such as a single assessment ratio on all property.

Appendix A – Per JLBC, Tax Jurisdictions in excess of 1% Limitation after homeowner’s rebate in FY 03:

COUNTY	SCHOOL DISTRICT
Cochise	Bisbee Unified
Cochise	Bowie Unified
Cochise	San Simon Unified
Cochise	McNeal Elementary
Cochise	Ash Creek Elementary
Gila	Miami Unified
Gila	Hayden-Winkelman Unified
Maricopa	Union Elementary
Pima	Tucson Unified
Pima	Empire Elementary
Pinal	Florence Unified
Pinal	Ray Unified
Pinal	Mammoth-San Manuel Unified
Pinal	Superior Unified
Pinal	Maricopa Unified
Pinal	Coolidge Unified
Pinal	Apache Junction Unified
Pinal	JO Combs Elementary
Pinal	Casa Grande Elementary
Pinal	Red Rock Elementary
Pinal	Eloy Elementary
Pinal	Picacho Elementary
Yuma	Crane Elementary